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Remarks

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Executive Secretary
1 April 1985

Date



OFFICE OF THE SECRETARY OF THE TREASURY
WASHINGTON, D.C. 20220

April 1, 1985

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MEMORANDUM FOR THE SECRETARY OF STATE
THE SECRETARY OF COMMERCE
THE SECRETARY OF AGRICULTURE
THE SECRETARY OF TRANSPORTATION
DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET
DIRECTOR OF CENTRAL INTELLIGENCE
UNITED STATES TRADE REPRESENTATIVE
ASSISTANT TO THE PRESIDENT FOR NATIONAL SECURITY AFFAIRS
ASSISTANT TO THE PRESIDENT FOR POLICY DEVELOPMENT
CHAIRMAN, COUNCIL OF ECONOMIC ADVISERS
DEPUTY SECRETARY OF THE TREASURY

SUBJECT: Senior Interagency Group on International Economic Policy

Attached are two discussion papers for the SIG-IEP meeting scheduled to be held on Tuesday, April 2, at 2:00 - 3:00 p.m. in the White House Situation Room. The Interagency Group on Japan prepared the paper on possible trade actions that could be used as leverage in market access negotiations with Japan. The more immediate focus for discussion, however, will be a report on the Sigur mission and responses thereto. Treasury prepared the paper on economic themes for the 1985 OECD Ministerial.

Edward J. Stucky
Edward J. Stucky
Acting Executive Secretary

cc: Staff Secretary and Deputy Assistant to the President
Deputy Assistant to the President for Cabinet Affairs

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March 29, 1985

The attached paper, prepared at the SIG's request, describes a variety of trade actions that could be used to increase leverage in market access negotiations with Japan.

The paper briefly discusses a range of specific actions, e.g., tariff hikes, initiation of a Section 301 case, imposition of simple or expandable quotas, and comments on their possible application in the negotiations. As recommendations are outside the scope of the SIG's request to the IG, this paper does not suggest a specific course of action.

Attachment

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ALTERNATIVE RESPONSES

Responding to the request of the SIG, the IG prepared this paper to examine trade actions that could be taken to increase our leverage in negotiations with Japan. Emphasis has been placed on actions that are thought likely to be practicable. In the interest of providing a range of possible measures, some actions have been included that might be challenged in U.S. courts or which are very limited in scope by domestic legislation. These potential problems are addressed in the discussion of individual actions.

The IG has not made a recommendation in the paper, since the SIG requested a discussion of alternatives, not a suggested course of action.

The use of leverage in these negotiations can have a variety of objectives. It may be intended to change behavior, to demonstrate that failure to open markets to our exporters carries a price, or to forestall Congressional action that would be more damaging than measures taken by the Administration. This paper is based on the assumption that, consistent with the MOSS approach, our fundamental goal is to induce Japan to provide adequate market access to our exporters. It follows that we would have to make clear to the Japanese what our expectations are, i.e., what conditions must be met in order to prevent U.S. action, or to bring about removal of trade restrictions we apply.

The following paragraphs briefly explore the domestic legal framework for applying trade restrictions to gain leverage, and outline possible actions.

Delay Entry at Customs: The Customs Service has authority to inspect each individual imported article. If utilized, this authority would greatly delay customs clearance. An arbitrary utilization of this inspection authority against some or all imports from Japan carries the risk of both domestic and international legal challenge. However, such inspection would not be arbitrary if the U.S. can point to a reasonable basis for believing that the Japanese products fail to meet entry requirements, e.g., they do not meet U.S. standards, to a greater extent than imports from other countries.

Section 301: To use his authority, the President must find that a foreign government or instrumentality maintains an act, policy, or practice that is "unfair." Such unfair acts can range anywhere from a blatant violation of the GATT to a denial of fair and equitable market access.

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In certain cases, a burden to U.S. commerce must also be shown. Burden can be shown relatively easily, e.g., by demonstrating that exports would be greater in the absence of the policy or practice. The President can act on his own motion or following an investigation and recommendation by USTR.

In using his 301 authority, the President can impose duties or import restrictions on goods, or fees or restrictions on services of the foreign country. Action on products is likely to take the form of tariffs or quantitative restrictions. The President has great discretion in the administration of such restrictions. Action on services can include the imposition of fees (e.g., \$500 every time a foreign ship enters U.S.), or restrictions (e.g., reporting requirements, prior approval), or denial of a Federal license (e.g., denial of trucking license).

The action need not be targetted at the same product or service which is the subject of the unfair practice. Also there is no requirement that the action be comparable in effect to the unfair practice. Thus, for example, an unfair practice in the service sector causing a \$10 million loss in trade can be met by a product import restriction affecting \$40 million in trade. The President has total discretion as to the scope and duration of 301 measures. It should be noted that where action is taken to restrict imports of goods, the U.S. is vulnerable to legal challenges in GATT for failing to meet its international obligations.

Unbinding Tariffs: The President has domestic legal authority to unbind tariff concessions pursuant to Sec. 125(c) of the Trade Act of 1974. However, the statute places limits on the level of tariff increase. Furthermore, international rules (Art. XXVIII) provide for compensation/countermeasures when tariffs are unbound. The U.S. has taken the position in other cases that compensation can be based not only on actual trade levels, but on potential exports. Thus, even if we unbind an item with little current trade, Japan could claim compensation on lost future trade.

Regulatory Bodies: We can use the regulatory bodies to signal that we are displeased with Japan and our relations are at risk. But it would be very difficult to implement measures that hurt Japan. The mandates of regulatory agencies are designed to provide fair, nondiscriminatory treatment to all suppliers and maximize consumer benefits. They are not designed to promote U.S. international trade objectives. Acts against Japan in this area are likely to be blocked by U.S. courts.

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A supposed advantage of using regulatory powers as leverage is that it might avoid giving Japan a GATT case. But if Japan can show discrimination against its products, even if by the regulatory bodies, it has a good GATT case anyway. And since the anti-Japan action by the regulators probably would not survive court challenge under domestic law, it is not an attractive option.

Options Legally Permissible Under Section 301

General - Initiate 301 Action

There is an option here of having the President make an immediate finding under 301 or having USTR initiate an investigation. The latter is discussed below. If the former is followed, there is a further option as to whether the President would immediately take action against Japan or would indicate his intention to take action in the future if Japanese practices do not change.

The USTR could initiate a Section 301 investigation in a specific area (such as telecommunications) to create leverage by establishing specific dates for hearings on whether Japanese policy or practices are burdening U.S. commerce, and on retaliation lists, thereby explicitly threatening retaliation. Such an investigation could be justified in telecommunications by explaining that Japan has maintained discretion in certain areas (such as registration and standards) that could be used to harm U.S. commerce. The Section 301 case would provide a framework for monitoring Japanese performance, while putting a mechanism in place that could be used to take quick trade action as necessary. Such an investigation would keep what we have obtained, keep on the pressure to get more, and could pre-empt Congressional proposals to initiate a Section 301 case through legislation. To be useful leverage, it is essential that the USG be prepared to act in case the threat of action is not sufficient.

Specific

Tariffs - Tariff increases, even if substantial, are not likely to have a significant impact on imports in the short term and, therefore, will not give us much quick leverage. A strong dollar and the Japanese expectation that large tariff increases would be temporary would encourage exporters to concentrate on holding markets at the expense of short-term profits.

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Simple Quotas - The U.S. could impose quotas on imports of Japanese goods and services. Quotas could be set at (a) a level roughly equal to U.S. exports to Japan of similar goods and services; or (b) a level roughly equal to current Japanese exports to the U.S. We would tell the Japanese that increases in the quotas would be based on increased sales of U.S. products and services in Japan.

Expandable Quotas - A more flexible and effective method would be to require that Japanese firms have USG approval before exporting specified goods and services to the U.S. The initial level of exports could be set at either of the levels described in the discussion of simple quotas, above. Increases in the initial level would be based on increased U.S. sales in Japan and/or Japanese actions to open their markets. The approval process under this approach would be simpler and could be more finely tuned to Japanese action than the more formal process of Presidential proclamations required for simple quotas.

Under either simple or expandable quotas the question will arise as to which Japanese firms will have the benefit of exporting to the U.S. This issue can be addressed in one of several ways:

1. Issue licenses to GOJ and GOJ distributes to individual firms;
2. Auction licenses to highest bidders;
3. Select individual Japanese firms based on their overall performance on such issues as whether their procurement is open to all competitive suppliers; or
4. Select individual Japanese firms on random basis.

In selecting products and services for use as leverage, it is worthwhile to look both at the sector in which we want barriers removed, and at areas in which Japan expects strong growth in exports to the U.S. For example, during the decade 1983-1993, Japan anticipates substantial gains in telecommunications equipment sales to the U.S.: customer premises equipment (11.27% per year); exchanges (10.23% per year); transmission devices (6.38% per year). Thus, a number of telecom products and services are good candidates for use as leverage. Several of these are listed on the attachment.

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To be effective, a leverage action should have a short-term impact. However, in the case of Japan it would be beneficial to include a longer-range element in our action as well. For selected products or services (e.g., value added networks-VANS) which Japan does not now offer, but plans to sell the U.S. in the future, we could establish conditions that would link Japan's ability to sell here with market access for similar U.S. products and services in Japan. This approach would not have an immediate impact on trade, but in combination with short-term measures would reinforce the message that opening its market is in Japan's long-run interest.

Attachment

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SAMPLE ITEMS FOR ACTION

<u>TSUSA Number</u>	<u>Description</u>	<u>Imports from Japan</u> (\$ millions)	
		<u>1980</u>	<u>1984</u>
6846210	Telephone Switching and Switchboard	66.8	317.3
6846240	Other Telephone Apparatus	28.5	221.6
676039	Data Processing Machines	-0-	1,212.1
6846220	Telephonic Apparatus and Instruments and Parts Thereof	24.3	182.3
70790	Fiber Optics	-0-	.5 (Jan. '85)

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1985 OECD Ministerial

U.S. Approach and Objectives "Partners for Growth"

Basic U.S. Approach and Overall Objective

To lay the groundwork for productive meetings of the Interim/Development Committees and the Summit countries in the following weeks, we should adopt "partners for growth" as our overall theme to the OECD Ministerial. Through the tone and substance of U.S. statements, we can take a constructive, cooperative approach to the issues, altering the impression that the U.S. does not take its trading partners' views into serious consideration. An important part of this approach would be to indicate that the U.S. takes the budget deficit seriously. However, on issues that are particularly contentious, such as the new trade round or the U.S. current account deficit, we should push other OECD countries to accept their responsibilities for improving the international economic situation.

We would like the Ministerial to conclude on a positive note with renewed optimism about U.S. understanding of other countries' problems and about the opportunities for sustained noninflationary growth in the world economy. This new tone is needed to help:

- establish a cooperative style/framework for the Spring Interim/Development Committee meetings following a week later; and
- ensure a successful Bonn Summit in early May.

Specific Objectives

A. Session I: Cooperation for Adjustment and Resumed Progress in Developing Countries.

- continue to stress with other OECD countries that the dialogue with LDCs should emphasize strengthening market forces and minimizing government intervention in LDC economies;
- note the progress that has been made in implementing the debt strategy and reaffirm it, resisting calls for increased concessional finance;
- encourage LDCs to liberalize trade and investment regimes;
- note the major U.S. contribution to addressing the crisis situation in sub-Saharan Africa.

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B. Session II: Strengthening the Rules of the Game,
Particularly in Trade

- Secure Ministerial endorsement for a new round of multilateral trade negotiations, to be launched in early 1986. If that is not possible, the United States should at a minimum strive for a formal commitment from the Ministers for a new round, to begin in 1986;
- will pave way for Bonn Summit endorsement;
- obtain agreement to hold a GATT preparatory committee meeting on the new round in July 1985;
- endorse Trade Committee agreement to consider over the next year ways to dismantle existing OECD trade barriers. However, this work on "rollback" of protectionist measures should not be given priority over new round;
- secure Ministerial agreement to improve discipline in the use of mixed credits by raising the minimum grant element significantly (ask for 50 percent; fallback to 30-35 percent now with a Ministerial directive that the grant element will automatically be raised to 50 percent by the next Ministerial if an effective alternative is not devised).
- reaffirm OECD commitment to avoid new protectionist measures;
- note in Communique need for continuing work in OECD on services, high technology, agriculture and fisheries.

C. Session III: OECD Economies in the Mid-80's.

- Agree that industrial nations have a shared responsibility for promoting growth worldwide;
- note that this requires actions by all countries to improve their performance:
 - agree that for the U.S. this means reducing our budget deficit in a manner consistent with growth, i.e. by cutting spending;
 - encourage Europeans to fulfill their responsibilities by improving the flexibility of their economies to promote stronger growth and job creation;

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- urge the Japanese to open their markets further to foreign products and to accelerate deregulation and liberalization of capital markets, reflecting their major role in the world economy;
- agree that for everyone it is imperative to maintain the anti-inflation stance of macro policy;
- secure agreement that the OECD should intensify its work in the structural adjustment area. This would involve a new, Secretariat study on the linkages between structural adjustment and job creation, and intensified work on this subject in appropriate OECD committees. The analytical paper, with progress reports from the committees, would form a major document for the 1986 Ministerial;
- provide examples of how the market-oriented approach to industrial restructuring in the U.S. has been successful.

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March 29, 1985

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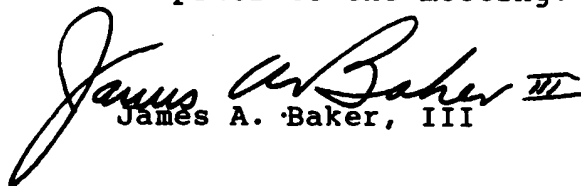
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DEPUTY SECRETARY OF THE TREASURY

SUBJECT: Senior Interagency Group on International Economic Policy

There will be a meeting of the SIG-IEP on Tuesday, April 2,
2:00 - 3:00 p.m. in the White House Situation Room. The agenda will
be:

1. Status of U.S.-Japan Trade Negotiations
2. Economic Themes for the OECD Ministerial

Papers will be circulated prior to the meeting.


James A. Baker, III

cc: Staff Secretary and Deputy Assistant to the President
Deputy Assistant to the President for Cabinet Affairs

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